

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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subject: Charitable contributions and REMICs

LEGEND

Taxpayer =

Year 1 =

Year 2 =

\$X =

\$Y =

\$Z =

FACTS

Taxpayer is a corporation that holds a residual interest in a real estate mortgage investment conduit (REMIC). In tax years Year 1 through Year 2, Taxpayer recognized excess inclusion income (EII) but otherwise had only net operating losses. Specifically, for tax year Year 1, Taxpayer recognized EII in the amount of \$X, had unspecified net operating losses (NOLs), and made a charitable contribution in the amount of \$Y.

Taxpayer asserts that its taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) of the Internal Revenue Code includes its EII under § 860E. Further, taxpayer asserts that its \$Y charitable contribution in Year 1 is deductible under § 170 because \$Y is less than 10 percent of Taxpayer's EII for that taxable year, or \$Z.

ISSUES

- (1) Does taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) of the Internal Revenue Code on corporate charitable contribution deductions include Taxpayer's EII under § 860E?
- (2) May Taxpayer in Year 1 deduct \$Y as a charitable contribution deduction under § 170 when Taxpayer only has EII and net operating losses during the taxable year of the charitable contribution?

CONCLUSIONS

- (1) Taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) means taxable income under § 63 as adjusted for EII under § 860E.
- (2) Taxpayer in Year 1 may not deduct \$Y as a charitable contribution deduction under § 170. In general, a holder of a residual interest in a REMIC may not offset EII by an otherwise allowable charitable contribution deduction, and, in this case, the taxpayer did not have other taxable income in Year 1.

LAW AND ANALYSIS

Section 63(a) generally provides that "taxable income" means gross income minus the deductions allowed by chapter 1 of the Code (other than the standard deduction). Under § 860E(a)(1) the taxable income of any holder of a residual interest in a REMIC for any taxable year is not less than the holder's excess inclusion for such taxable year.

Section 170 provides a deduction for qualified charitable contributions. However, under § 170(b)(2)(A), deductions for charitable contributions made by a corporation is limited to a maximum of 10 percent of the corporation's taxable income for the taxable year.

For purposes of calculating the percentage limitation under § 170(b)(2)(A), a corporation's taxable income is defined as taxable income under § 63 computed without regard to—

- (1) the deduction for charitable contributions under § 170;

- (2) the special deductions for corporations allowed under part VIII (except § 248, relating to organizational expenditures), subchapter B, chapter 1 of the Code;
- (3) any net operating loss carryback to the taxable year under § 172;
- (4) section 199; and
- (5) any capital loss carryback to the taxable year under § 1212(a)(1).

Sec. 170(b)(2)(C); § 1.170A-11(a) of the Income Tax Regulations.

Under section 860E, the taxable income of a holder of a residual interest in a REMIC is not less than the holder's excess inclusion. Taxable income for purposes of calculating the percentage limitation under § 170(b)(2)(A) on corporate charitable contributions is adjusted only by the items listed in § 170(b)(2)(C). Section 170(b)(2)(C) does not provide an adjustment for EII under § 860E. Therefore, the general rule that the taxable income of a holder of a residual interest in a REMIC is not less than the holder's excess inclusion applies. That is, pursuant to § 860E (and despite Taxpayer's NOLs), Taxpayer's taxable income in Year 1 is \$X. As a result, Taxpayer's percentage limitation under § 170(b)(2)(A) is 10 percent of \$X, or \$Z.

Under § 170(b)(2)(A), Taxpayer's deduction for charitable contributions made in Year 1 is limited to \$Z. However, even though \$Y is less than \$Z, Taxpayer may not necessarily deduct its Year 1 qualified charitable contribution. Instead, Taxpayer's otherwise allowable deductions (including the charitable contribution deduction under § 170) may be limited under other provisions of the Code such as § 860E.

Under § 860E a taxpayer's EII may not be offset by otherwise allowable deductions. Section 1.860E-1(a) provides as follows:

Excess inclusion cannot be offset by otherwise allowable deductions—(1) In general. Except as provided in paragraph (a)(3) of this section, the taxable income of any holder of a residual interest for any taxable year is in no event less than the sum of the excess inclusions attributable to that holder's residual interests for that taxable year. In computing the amount of a net operating loss (as defined in section 172(c)) or the amount of any net operating loss carryover (as defined in section 172(b)(2)), the amount of any excess inclusion is not included in gross income or taxable income. Thus, for example, if a residual interest holder has \$100 of gross income, \$25 of which is an excess inclusion, and \$90 of business deductions, the holder has taxable income of \$25, the amount of the excess inclusion, and a net operating loss of \$15 (\$75 of other income - \$90 of business deductions).

Under § 1.860E-1(a) of the regulations (subject to an exception relating to certain financial institutions not here relevant), the taxable income of any holder of a residual interest for any taxable year is in no event less than the sum of the excess inclusions attributable to that holder's residual interests for that taxable year. Accordingly, to the extent of EII, the taxable income of the holder of the residual interest in the REMIC may not be offset by a charitable contribution deduction otherwise allowable to the holder

under § 170. Assuming all other requirements under § 170 are satisfied, Taxpayer in Year 1 may only deduct \$Y to the extent Taxpayer's other taxable income exceeds its EII. In this case, Taxpayer has no other taxable income, and, therefore no part of the \$Y charitable contribution is deductible in Year 1.

If you have any questions regarding the § 170 issue, please call Nancy Lee (CC:ITA:B01) at _____, and if you have any questions regarding the § 860E issue, please call Richard LaFalce (CC:FIP:B02) at _____.